

BPAC

AGENDA ITEM NO. 4

PUBLIC HEARING AND  
COMMITTEE RECOMMENDATION:  
PROPOSED REGULATIONS  
GOVERNING DETERMINATION OF  
“EMPLOYEE” STATUS

Attachment C

Summary of Written Comments  
and Responses

## **ATTACHMENT C**

### **SUMMARY OF WRITTEN COMMENTS AND RESPONSES**

#### **1- What is the purpose of the proposed regulations?**

Government Code section 20028 generally defines “employee” for the purposes of the PERL. The proposed regulations require that the term employee be determined using the common law test for employment. The regulations seek to make specific, interpret and apply the Public Employees’ Retirement Law (PERL), the case law and the Board of Administration’s Precedential Decisions which set forth the applicable criteria of the common law test for employment.

The purpose of the proposed regulations is to set forth the factors that are central to the proper determination of employee status and therefore, the eligibility for CalPERS membership for retirement benefits. The regulations are necessary because under the Internal Revenue Code, assets of our plan must be held for the “exclusive benefit” of the participating employer’s employees and their beneficiaries in order to preserve the plan’s tax-qualified status. CalPERS cannot knowingly provide retirement benefits to individuals who are not employees under the common law test of employment.

#### **2- Are the proposed regulations authorized by law? Do they misread or change existing law?**

The regulations are authorized by Government Code section 20125 which provides that the Board shall determine who are employees and is the sole judge of the conditions under which persons may be admitted to and continue to receive benefits under this system.

The proposed regulations do not misread the law. Instead, the regulations apply the law that has been articulated by the California Supreme Court and in Precedential Decisions by the Board of Administration.

The proposed regulations cite to two California Supreme Court decisions, *Metropolitan Water District v. Superior Court* (2004) 32 Cal. 4th 491, (*Cargill*) and *Tieberg v. Unemployment Ins. App. Bd.* (1970) 2 Cal. 3d 943 (*Tieberg*).

The California Supreme Court held in *Cargill* at page 509, when determining whether individuals are employees of a public agency, CalPERS must apply the common law test for employment.

At least one comment suggests that the Supreme Court's determination in this regard was only meant to apply to determinations where individuals were to be brought into CalPERS membership and should not be used to exclude individuals from membership. Although the Court in *Cargill* referenced the common law test for employment to provide CalPERS pension benefits to common law employees of Metropolitan Water District, CalPERS has also used the same test to determine employee status and eligibility and/or to deny eligibility for pension benefits to any persons who are not the common law employees of a CalPERS employer. The Board of Administration recently discussed this in a Precedential Decision stating: "as the California Supreme Court held in *Metropolitan Water District v. Superior Court* (2004) 32 Cal.4<sup>th</sup> 491, 509 (*Cargill*), when determining whether individuals are employees of a public agency, CalPERS must apply the common law test for employment."<sup>1</sup> The Board of Administration adopted the proposed decision of the Administrative Law Judge upholding a CalPERS determination that the common law test for employment also may be used to deny pension benefits to any persons who are not the common law employees of the employer.

CalPERS staff considered the language used in *Cargill* and *Tieberg* when drafting the proposed regulations. Section 578.1, subdivision (b) provides:

The most important factor in determining employee status is the right of the entity seeking to have the services performed to control the manner and means of accomplishing the result desired, regardless of whether that right is exercised with respect to all details.

The proposed regulations do not change the meaning of the "control" factor. Subdivision (b) is consistent with language recognized by the Supreme Court in both cases cited above which provides:

In determining whether one who performs services for another is an employee or an independent contractor, the most important factor is the right to control the manner and means of accomplishing the result desired. If the employer has the authority to exercise complete control, whether or not that right is exercised with respects to all details, an employer-employee relationship exists. Strong evidence in support of an employment relationship is the right to discharge at will, without cause.

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<sup>1</sup> *In the Matter of the Application to Contract with CalPERS by Galt Services Authority*, Precedential Decision No. 08-01, (2008). (*Galt Services Authority*)

One commenter also suggests that the Board must recognize a discussion in a 1989 California Supreme Court case<sup>2</sup> relating to another proposed common law factor. CalPERS staff disagrees because the discussion referred to in the public comments was not subsequently adopted or discussed by the Supreme Court in 2004 in the *Cargill* majority opinion, when it specifically decided what the PERL means by "employee."<sup>3</sup>

### **3- From where do the factors included in the proposed regulations come?**

As noted above, the California Supreme Court held in *Cargill* at page 509, when determining whether individuals are employees of a public agency, CalPERS must apply the common law test for employment. In the Supreme Court's discussion, the factors identified in *Tieberg* were referenced. The proposed regulations incorporate these factors and make specific that the common law test for employment is applicable to CalPERS employee determinations. Additionally, the regulations incorporate the Board's Precedential Decisions in the *Neidengard* and *Galt Services Authority* cases which also refer to the factors referenced in *Tieberg* and *Cargill*.<sup>4</sup>

### **4- Will the proposed regulations potentially eliminate CalPERS eligibility for hundreds or thousands of CalPERS members?**

No specific examples or concrete data were provided to support the assertion that the proposed regulations may potentially eliminate CalPERS eligibility for hundreds or thousands of CalPERS members.

The proposed regulations will not eliminate CalPERS membership eligibility for CalPERS participating employers' common law employees. To the extent individuals are not the common law employees of CalPERS employers, they will have been reported to CalPERS in error. Where CalPERS discovers such errors in membership reporting, corrective action is taken on a case-by-case basis. If ultimately a determination is made that an individual fails to qualify for CalPERS membership under the common law employment test, then service credit must be backed out and member contributions must be refunded.

### **5- Should the proposed regulations be expanded to include joint or co-employment?**

CalPERS staff disagrees that the proposed regulations be expanded to take into account co-employment.

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<sup>2</sup> *Borello & Sons v. Department of Industrial Relations* (1989) 48 Cal.3d 341.

<sup>3</sup> See *Cargill*, supra, at page 501.

<sup>4</sup> See *In the Matter of the Application for CalPERS Membership Credit by Lee Neidengard v. Tri-Counties Association for the Developmentally Disabled*, Precedential Case No. 05-01, (2005) (*Neidengard*) and *In the Matter of the Application to Contract with CalPERS by Galt Services Authority*, Precedential Decision No. 08-01, (2008). (*Galt Services Authority*)

After review of IRS authority cited in one comment<sup>5</sup>, staff concludes that the cited authority is not germane to the proposed regulations; the co-employment concept arises in different circumstances for different purposes than CalPERS membership eligibility under the PERL and is beyond the scope of the proposed regulations for reasons including, but not necessarily limited to, the following:

1. CalPERS is bound to follow the applicable law on qualification for CalPERS membership. The proposed regulations clarify and apply the PERL, the case law and the Board's Precedential Decisions concerning employee status under the common law test for employment.
2. The cited authority discusses co-employment solely in the context of determining an employers' liability to pay federal employment taxes on behalf of its common law employees. It does not discuss co-employment in the context of membership eligibility under the PERL, or in the context of which employer may be eligible to contract with CalPERS to enroll its employees.
3. The cited authority discussion on co-employment comes up only after the common law employment test has been applied to establish the employer-employee relationship with more than one employer.

The fact that an individual may be co-employed or jointly-employed under a statutory scheme other than the PERL is not relevant to the issue of whether that individual providing services to a CalPERS employer qualifies as an employee of that employer under the PERL.

The proposed regulations ensure that only the common law employees of an employer who has contracted to participate in the plan (regardless of whether that employer also has established a co-employment relationship with another employer for purposes other than the PERL) are reported into membership.<sup>6</sup>

The Board has referred to the common law test for employment factors in two Precedential Decisions, *Neidengard* and *Galt Services Authority*, when examining questions relating to employee status. Conversely, the Board has never issued a Precedential Decision recognizing "co-employment" as a basis for CalPERS membership eligibility.

## **6- Why do the proposed regulations fail to address statutory employment?**

CalPERS staff did not include in the proposed regulations any discussion of "statutory employment," because the topic is irrelevant to determining employee status and individual eligibility for CalPERS membership. The crucial inquiry

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<sup>5</sup> Chief Counsel Advice Memorandum 200415008, which cites Revenue Ruling 66-162

<sup>6</sup> This is consistent with the Court's discussion of this issue in *Cargill*, *supra*, 32 Cal.4<sup>th</sup> at p. 506.

under the PERL is whether an individual is the common law employee of an employer that contracts with CalPERS and that reports the individual into membership for such service. If an individual is a common law employee of an employer that contracts with CalPERS, then that employee is eligible for membership (absent a specific statutory or contract exclusion from membership). Whether an employer may have the general statutory authority to hire employees is not relevant to the common law employee analysis.

#### **7- Has the board previously adopted exceptions to the common law test for employment?**

The Board has not issued any Precedential Decisions which adopt exceptions to the common law test for employment when determining employee status under the PERL.

Comments reference a prior decision and contend the Board adopted joint and co-employment as an exception to the common law test for employment.<sup>7</sup> However, that decision was not designated as "Precedential" by the Board, so it is limited to its own specific facts and has no binding effect on the Board as to future matters. Furthermore, although the decision may have lacked clarity in its drafting, quoted language cited in one comment actually lends support to the proposed regulations---that is, the entity that contracted with CalPERS was ultimately found to be the common law employer of the employees who were reported into CalPERS membership, and as such, the employees of that employer were found to be eligible for membership. Moreover, that decision made no definite finding on the issue of co-employment, only noting that one entity "might" be viewed as a co-employer.

One of the comments also suggest that a preliminary ruling by an Administrative Law Judge in an administrative case currently pending represents findings by the Board of Administration. Staff disagrees because the Administrative Law Judge's ruling is nothing more than a preliminary order to allow an argument to be made at the future hearing, and since the case has not come before the Board of Administration yet, the order does not demonstrate any finding by the Board of Administration.

#### **8- Should the regulations be changed to address "certain employment relationships"?**

One commenter suggests that the proposed regulations do not take into account certain employment relationships that already exist in California and do not leave CalPERS sufficient discretion to deal with these existing relationships and similar circumstances that may arise in the future.

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<sup>7</sup> *In Re the Matter of Sonoma County Office of Education, Santa Rosa Junior College District, College Legal Services of California, Henry, Shumway and Sisneros*, CalPERS Case Nos. N2004080538, N2004080539, N2004120064.

CalPERS staff disagrees that it should expand the proposed regulations to cover more than the determination of employee status under the common law test for employment. The proposed regulation has a limited purpose---making specific the criteria for employee determinations.

In addition to being beyond the scope of the proposed regulations, the suggestion that the regulations be changed to address "certain employment relationships" is too vague for any action. The employment relationships are neither identified nor described in any detail, so it is not possible for CalPERS staff to discern what changes or additions would address the commenter's concerns. An IRS private letter ruling was cited in support of the comment, but we note that the issue addressed in that private letter ruling<sup>8</sup> was different from and beyond the scope of the proposed regulations.

### **9- Should additional factors be added to the proposed regulations?**

One commenter suggests that several additional factors be added into the text of section 578.1, one of the proposed regulations. The suggested additions are as follows:

- "Whether or not the individual performing services can work for others and can make a profit or loss."
- "Whether or not the kind of occupation is often part of industry practice."
- "The type of training necessary in the particular occupation and the source of such training."
- "The length of time for which the services are performed *under contract and if the contract specifies an end date or a continuing relationship.*" (The commenter requested the portion in italic be added to section 578.1, subdivision (c)(5).)
- "Whether or not there are set work hours."
- "Whether or not the individual performing services receives any benefits that are provided to the employees of the business entity."
- "Whether or not the parties believe they are creating the relationship of employer and employee *and there exists signed contracts by both parties evidencing such.*" (The commenter requested the portion in italic be added to section 578.1, subdivision (c)(8).

Staff concludes that this additional language should not be added to the proposed regulations. The suggested additions included criteria that were not included in the common law test for employment articulated in the Supreme Court's *Cargill* and *Tieberg* decisions or in the Board's Precedential Decisions in *Neidengard* and *Galt Services Authority* cases.

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<sup>8</sup> The issue addressed in PLR 9813019 was whether the status of a governmental plan would be adversely affected by covering employees of non-public entity employers.

## **10- Are the proposed regulations vague and open to arbitrary application?**

The proposed regulations are neither vague nor open to subjective and arbitrary application. As detailed above, the factors articulated in the proposed regulations are taken from Supreme Court decisions and Board Precedential Decisions which incorporate the common law test for employment. These decisions provide guidance and illustrate how the test is to be applied. Setting forth the common law test for employment in regulations removes questions as to what criteria should be applied when making employee determinations.

### **Statement on correction of erroneous reporting**

One comment suggests CalPERS utilize the IRS Employee Plans Compliance Resolution System to correct prior reporting errors.<sup>9</sup> The commenter asserts that "To the extent that individuals who do not technically qualify as 'employees' under the definition proposed by CalPERS, [they] are not required to be 'kicked out' of CalPERS to correct potential violations of the federal tax [law]." The commenter further contends that the IRS has procedures for governmental plan corrections in order to maintain tax qualified status. The commenter then suggests that CalPERS may be allowed to correct "past eligibility errors by simply amending the retirement plan to include employees who were allowed to participate in error."

Staff concludes that this suggestion on how CalPERS might correct past erroneous reporting of persons who are not entitled to CalPERS membership is informational, rather than a comment on the proposed regulations. Nevertheless, staff reviewed the cited IRS revenue procedure, and it appears that the correction method referred to would not be applicable.<sup>10</sup>

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<sup>9</sup> See Rev. Proc. 2008-50.

<sup>10</sup> The cited correction method at Rev. Proc. 2008-50, Appendix B, section 2.07(3)(a) is available only as to an operational failure of including an "otherwise eligible employee in the plan", among other requirements, and since the hypothetical facts in the comment letter provided that the individual would not technically qualify as an employee (and may not meet other requirements, as well) it appears that the suggestion to use the IRS correction procedure would not be viable.